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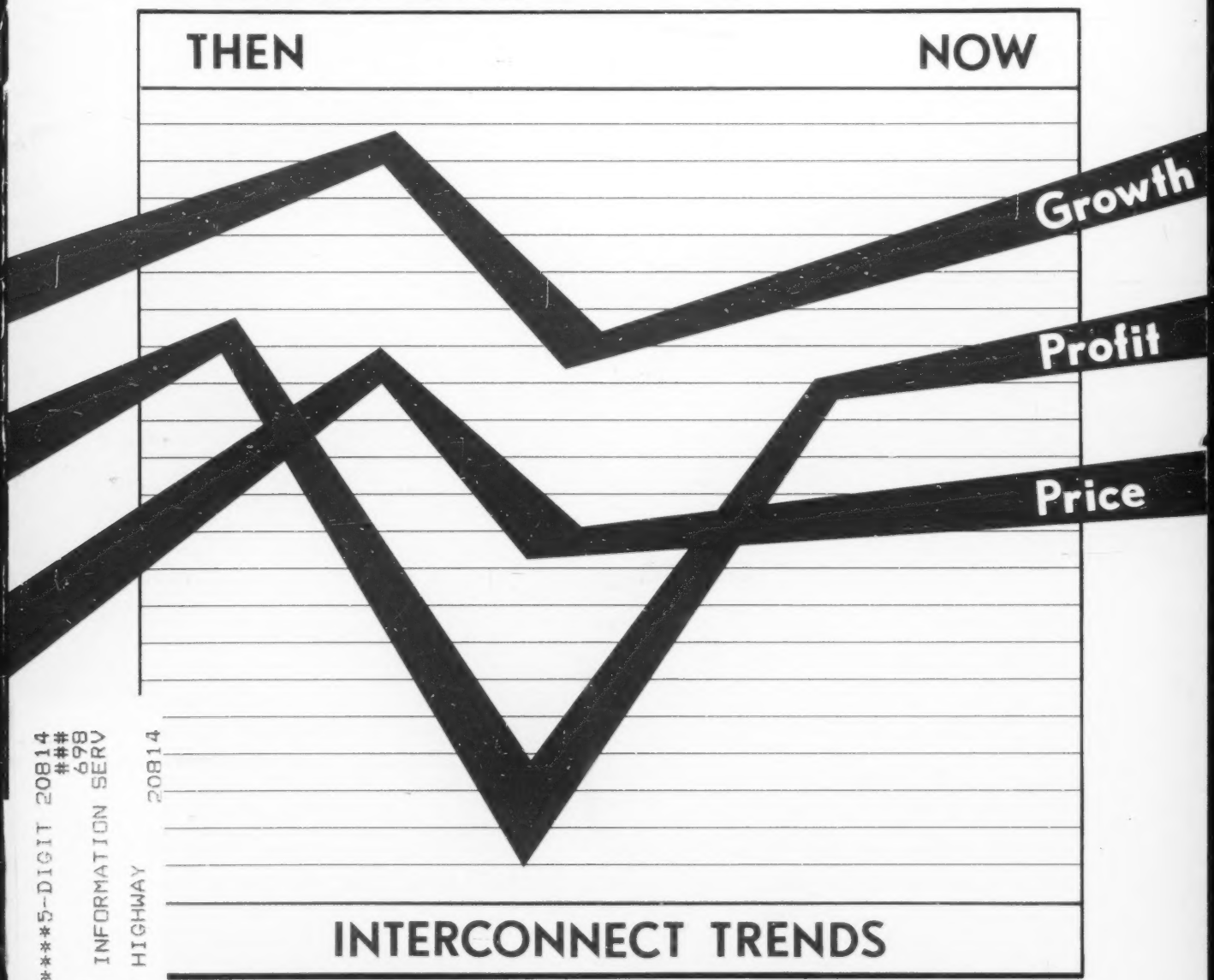

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The Top 25 Interconnects: Trends and Challenges

CZATDANA INAN, MARKET RESEARCH DIRECTOR, AND LARRY LANNON, EXECUTIVE EDITOR

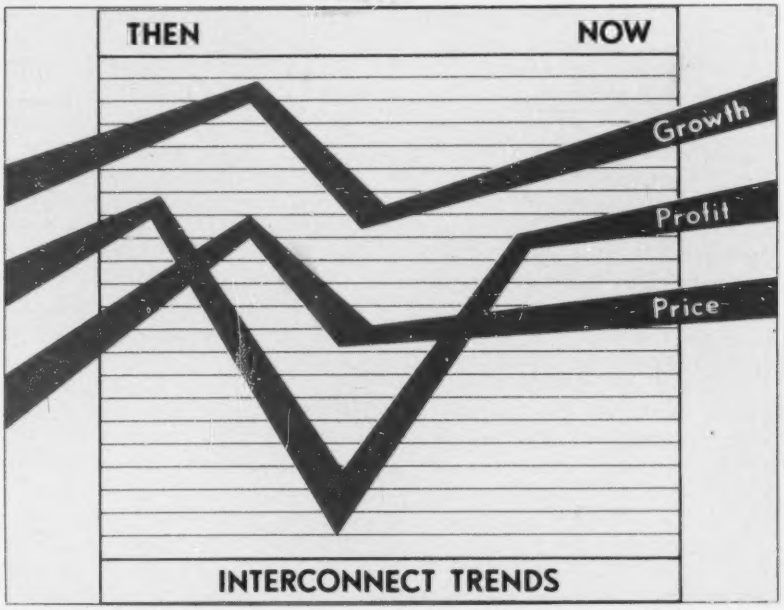
THE MAJOR interconnects will stress return on investment this year and next as they move to consolidate following a wave of mergers and acquisitions. Sales are up, but profits down in the industry. Improvement in the profit picture is expected, though, as the major interconnects capitalize on their increased customer bases, bases they built and paid for in the coin of the realm: by sacrificing profits in '84 and '85. A new day is dawning.

Vicious price competition and rising tides of red ink have scarred the interconnect industry. Mergers and acquisitions have been the preferred antidotes. But the antidotes haven't always worked, and some patients have been lost.

Now, however, the industry is poised on the doorstep of a new—and for some—more profitable phase. Work done by TELEPHONY's Market Research Department indicates that the major changes currently sweeping the industry will continue to make themselves felt and radically affect the industry's future.

Not that the new phase will be less competitive. Competition will take new forms, and new competitors will play even larger roles. But the competition itself will be as fierce as ever. Inefficient or less capable interconnects will find themselves under mortal siege by large competitors free to compete with fewer restrictions than they have had. To top it all off, Centrex is more competitive than ever.

Six major changes will clearly differentiate the new phase from the industry's earlier phases. There will be a new emphasis on selling to existing customers, rather than on further expanding the customer base. Consequently, it will be more important than ever to sell applications rather than substitutes, which will be further incentive for interconnects to bring the latest in information processing technology to the market. Those two factors, in turn, will lead to hot competition for the top end of the market.



Cover art by Sharon Manjack

After some hard years, things are looking brighter for the interconnect industry.

Fourth, instead of cutting prices in ever more frenzied attempts to build or retain market share, interconnects will defend price levels and attempt to bolster margins. Defending price levels will entail increasing productivity and consolidating operations. Finally, the new phase will see the interconnect subsidiaries of regional holding companies mature as dominant players in a more highly structured industry.

These six changes are obviously closely related. For instance, the drive to boost margins by defending price levels is furthered by the interest in selling to existing customers, since customers who are familiar and satisfied with a vendor are much less likely to make decisions based solely on price.

Individually, these six major changes are neither new nor decisive in reshaping the industry. Collectively, they are new and will be decisive. Their impact will exceed the sum of their parts.

One thing about the interconnect industry seems unlikely to change. Hard information—about sales, financing, customers—is hard to come by. Information is seen as a marketing weapon in a business so competitive that small advantages loom large. On the other hand, interconnect decisionmakers frequently express themselves bluntly about market forces and their own intentions. The interconnect industry generally hoards data, but freely talks about how to interpret the market, an approach to information which has its roots in the industry's highly competitive atmosphere. It is important that potential customers know what an interconnect company can do and how it plans to do it, and it is just as important that competitors do not know how well

that interconnect has succeeded in doing what it would like to do.

TELEPHONY's Market Research Department contacted the top 25 interconnects for this story and asked them to supply both hard data and an explanation of how they planned to attack the market. (For a note on methodology, see sidebar.) The top 25 interconnects include seven companies which are affiliated with regional holding companies and five which are affiliated with non-Bell carriers. Three of the top 25 are affiliated with retailers. Ten are not affiliated with any telecommunications carrier, retailer or manufacturer.

Table 1 is an index of the TELEPHONY top 25 interconnects. The RHC-affiliated interconnects are lumped into a single entry because only one will break out earnings. However, TELEPHONY's Market Research Department estimates the seven RHC interconnects will do approximately $800 million in business in 1986. In addition, detailed information on seven of the top 25 interconnects is presented in sidebar form.

The non-affiliated interconnects are Telecom Plus International, Norstan Communications Systems, the Telephone Systems Division of RCA Service Co., Universal Communications Systems, Communications Corp. of America, Honeywell Communications Services Division, Jarvis Corp., Henkels & McCoy/Telecom Systems, Standard Telecommunications Systems and Gray Communications. Businessland, Tandy's Radio Shack and Sears Business Systems Centers are affiliated with retailers. Centel Business Systems, Contel Executone, C-TEC, SNET's Sonecor and Rochester Telephone's Rotelcom are affiliated with non-Bell carriers. The RHC affiliates are U S West Information Systems, Southwestern Bell Telecom, PacTel InfoSystems, Bell Atlanticom Systems, Nynex Business Information Systems, Ameritech Communications and Bell-South's Advanced Systems.

The RHC interconnects volun-

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TABLE 1 INTERCONNECT RESULTS

Index of the top 25 interconnects
(Sales in millions of dollars)

	1983	1984	1985
RHC Affiliates		650.0*	715.0*
Non-Bell			
Centel Business Systems (a)	205.2	219.7	193.1
Contel/Executone	178.0*	195.0*	215.0*
C-TEC Corp. (b)	13.6	14.8	19.5
Sonecor Systems (c)	15.1	58.3	76.9
Rotelcom	15.0*	18.0*	22.0
Retailers			
Businessland	10.1	89.6	267.5
Tandy Corp.	na	na	na
Sears Business Systems	na	na	na
Non-affiliated			
Telecom Plus	106.2	155.2	240.9[d]
RCA Telephone Systems	102.5*	105.0*	110.0*
Universal Communications Systems	52.6	64.9	66.4
Communications Corp. of America	46.1	62.1	50.1
Honeywell Communication Services	56.0*	65.0*	73.0*
Norstan Communications Systems	25.3	31.8	80.0[e]
Henkels & McCoy/Telecom Systems	26.0	34.0	35.0*
Jarvis Corp.	24.5	26.7	31.5
Standard Telecommunications	17.2	19.7	18.1
Gray Communications	10.9	14.8	16.4

* estimated by Telephony

a: sales to customers other than regulated affiliates less sales of non-affiliated supply business sold January 20, 1986.

b: formerly Commonwealth Communications

c: Southern New England Telephone's Telecommunications Group sales. Group posted net loss of $26 million in 1985, $20.9 million in 1984 and $7.5 million in 1983. Increase in 1985 loss primarily attributable to $9 million adjustment in Sonecor Systems' inventory to current market value.

d: acquired Compath

e: acquired Electronic Engineering Co.

na: not available

METHODOLOGY

TELEPHONY's index of the top 25 interconnects is designed to account for general economic conditions, shifts in distribution channels and trends in new targeted markets. It is based on 25 interconnects in the three basic sectors of the market: the telcos' CPE subsidiaries and affiliates, major retailers and interconnects not majority-owned or direct sales arms of manufacturers. Non-affiliated interconnects with $15 million to $25 million in annual sales doing business in key metropolitan or regional areas are included to more clearly reflect temporary economic gliches in areas of the country—for example, the effect of sliding oil prices in Texas—not immediately apparent in the profiles of the larger non-affiliated interconnects with multiregional and national customer bases. The smaller interconnects can and do change from year-to-year.

This year's index includes Businessland, which acquired the AmeriSource stores, included in last year's index. Compath, acquired by TelPlus of Telecom Plus International, was replaced by Gray Communications, which acquired the Pennsylvania locations of Sonecor Systems. The 25 companies in this year's index were asked to respond in terms of their total sales, cost of sales, net income, total assets, total inventory level, orders booked, total employees, locations, and PBX and key system lines installed for the period 1983-85. They were also asked to list the voice communications, data communications, administrative equipment lines and any network services included in their offerings. Twenty-one of the 25 responded in part or with complete information.

The regional holding companies' CPE subsidiaries were cooperative in providing product line information along with total employees and locations. Most balked at installed lines, inventory levels and orders booked.

With the exception of Businessland, the major retailers also balked at providing financial information. □

Gray Communications

	1983	1984	1985	Est 1986
Financials ($000)				
Sales	$10,976	$14,841	$16,413	$22,000
Inventory	$ 2,158	$ 3,806	$ 4,167	$ 4,400
Total Employees	193	217	214	250
Total Locations	5	6	6	7
Installed/Cum				
PBX Lines	16,500	29,500	50,120	90,000
KS Lines	10,500	16,850	24,170	34,000

Standard Telecommunications Systems, Inc.

	1983	1984	1985	Est 1986
Financials ($000)				
Sales	$17,236	$19,715	$18,065	$22,000
Cost of Sales	10,738	12,425	11,075	13,487
Assets	$10,936	$12,476	$11,780	$12,000
Inventory	$ 2,985	$ 3,487	$ 3,506	$ 3,900
Total Employees	260	247	200	230
Total Locations	9	5	5	5
Installed/Cum				
PBX Lines	45,000	50,000	52,000	65,000
KS Lines	5,000	7,000	20,000	23,000

teered little hard information. However, Southwestern Bell Telecom projects a 12% increase in 1986 sales from $100 million in '85 to $112 million. In addition, Ameritech reported 1984 sales of $100 million. Therefore, it seems likely, based on the admittedly meager data on hand, that as a group the RHC interconnects will probably do about $800 million in business this year, a substantial increase from the $650 million to $700 million they did in 1984, figures which would have been somewhat larger had Advanced Systems not gotten a late start.

The RHCs also are increasing staff while holding sales locations constant. For instance, Southwestern Bell Telecom increased staff to 1000 this year from 820 in 1984 but still has the 12 sales locations now it had then. The company also reported that PBX installations increased from 24,700 in 1984 to 30,690 in 1985. Bell Atlanticom reported that its 500 employees are scattered around 13 locations. It has an installed base of 150,000 PBX and key system stations.

U S West Information Systems has a staff of 1878 employees at 53 sales locations; that count includes both the Interline and Business Sales and System (formerly known as FirsTel) groups. Thanks in large part to its acquisition of the IBM Product Centers, Nynex Business Information Systems reported that its work force increased from 1500 to 2500 employees during the past year, and the number of locations soared from 17 to 115.

Among the non-affiliated interconnects, Telecom Plus International reported losses in 1985 attributed to the higher than anticipated costs of consolidating Compath National's operations into its corporate structure. However, the Compath National acquisition did provide Telecom Plus entry into growth markets in the Pacific Northwest and on the West Coast, and increased its installed customer base by 36% to more than 45,000. The company also obtained more than $85 million in new funds when Siemens of West Germany increased its ownership from 20% to 35%. These moves could be a prelude to a long-term strategy for merging telecommunications and information processing markets in conjunction with Telecom Plus Software Systems and American Consolidated Technologies, a wholly owned subsidiary of Telecom Plus which manufactures inside wiring products.

Among the other non-affiliated in-

Continued on page 87

C-TEC Corp.
(Formerly Commonwealth Communications Enterprises)

	1983	1984	1985	Est 1986
Financials ($000)				
Sales	$13,583	$14,829	$19,521	$26,414
Cost of Sales	8,881	8,370	10,991	15,357
Net Income (a)	743	1,053	1,344	1,568
Total Employees	82	136	163	210
Total Locations	1	3	2	5
Lines Installed[b]				
PBX Lines	3,500	1,300	3,950	1,500
KS Lines	1,400	2,200	1,200	1,900

a: after other expenses including taxes
b: annual installations

Communications Corp. of America (CCA)

	1983	1984	1985
Financials ($000)			
Sales	$46,087	$62,079	$50,097
Cost of Sales	37,501	52,635	45,967
Net Income (a)	$(1,757)	$(5,050)	$(13,384)
Assets	$41,367	$43,999	$43,580
Inventory	$18,787	$20,877	$22,831
Orders Booked	$36,943	$50,187	$34,874
Total Employees	nr	nr	500
Total Locations	nr	nr	23
Installed/Lines			
PBXs	nr	nr	564,900[b]
Key Systems	nr	nr	210,500[c]

a: Net income after other expenses
b: represents 1,310 PBX systems
c: represents 6,539 KS systems

Interconnect

Continued from page 32

terconnects, Norstan, which purchased Electronic Engineering last year, reported sales jumped from $31.8 million in 1984 to $80 million in 1985. CCA, which saw sales drop from $62.1 million in 1984 to $50.1 million last year, estimates 1986 sales at $55 million. Standard Telecommunications anticipates $22 million in sales in '86, up from $18.1 million in '85 and $19.7 million in '84.

RCA Telephone Systems, which will not reveal sales or financial figures, did confirm that our estimates are within 10%. RCA Telephone is one of the non-affiliated interconnects which continues to concentrate on voice systems. Others, notably CCA, are more aggressively moving into data. In fact, CCA sells DEC mini and mainframe computers.

Some interconnects do not confine their efforts to CPE equipment. For example, Telecom Plus International sells US Sprint's WATS service. Standard Telecommunications sells

Universal Communications Systems

	1983	1984	1985
Financials ($000)			
Sales	$52,600	$64,900	$66,400
Cost of Sales	44,800	56,900	56,600
Assets	$31,900	$34,000	$34,300
Inventory	$15,100	$10,900	$10,900
Total Employees	nr	537	595
Total Locations	nr	nr	200
KS Lines Installed	nr	nr	573,969

Telecom Plus International

	1983	1984	1985
Financials ($000)			
Sales	$106,196	$155,223	$240,932
Costs*	132,537	163,534	274,359
Income	$(26,341)	$ (8,311)	$(33,427)
Assets	$169,324	$235,456	$238,922
Inventory	$ 19,150	$ 60,770	$114,255
Total Employees	1,600	1,700	3,140
Total Locations	60	95	99
Installed/Cum			
PBX Lines	na	360,000	1,400,000
KS Lines	na	440,000	650,000

* includes depreciation and G&A expenses. Cost of sales was $94 million, $117 million and $188 million, 1983-85, respectively.

Interconnect

Continued from page 87

New York Tel's Centrex service and US Telephone's long-distance services.

Among the interconnects affiliated with non-Bell carriers, Centel Business Systems reported a drop in sales from $219.7 million in 1984 to $193.1 million in 1985. Centel Executone's sales rose from $195 million in 1984 to $215 million in 1985, according to our estimates. Over the same period, C-TEC reported an increase from sales of $14.8 million in 1984 to $19.5 million in 1985, Sonecor Systems' sales went from $58.3 million in 1984 to $76.9 million in 1985, and Rotelcom's sales, according to our estimates, went from $18 million in '84 to $22 million in '85.

Among the interconnects affiliated with retailers, an interesting and secretive group, Businessland was the big surprise. It bought the AmeriSource stores from United Telecom and transformed them into Businessland Centers. Businessland Centers, unlike AmeriSource stores, do not sell traditional telephone-related products. They sell IBM micros, private label modems, and the Apple, Compaq and Hayes line of computers. The company is well-positioned to meet the needs of small data communications users. The acquisition of AmeriSource stores boosted Businessland's employees from 1500 to 2000, and increased its locations from 65 to 140, a ratio of seven employees per store.

Sears Business System Centers have five to 10 employees in each of their 103 locations. They sell AT&T and Trillium key systems and AT&T and Hayes modems. Radio Shack is concentrating on the small business user, too, and is offering cellular equipment.

The competition from the re-

Centel Business Systems

	1983	1984	1985
Financials ($000)			
Sales			
Regulated Affiliates	36,957	38,068	40,489
Other Customers (a)	267,186	275,619	235,080
Expenses	300,903	302,928	281,066
Income	3,240	10,759	(5,497)
Assets	142,132	171,470	133,841
Order Backlog	61,268	96,768	71,411
Total Employees	2,096	2,111	1,941
Total Locations	52	52	56
PBX/KS Lines			
Cummulative	578,000	700,085	825,171

a: adjusted in Table 1 to reflect sale of non-affiliated supply business assets and sales attributable of $62.0 million, $55.9 million and $41.9 million in 1983-85, respectively.

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tail giants is making life rough for the smaller interconnects which would like to serve the smaller users.

Like the carriers, though, the interconnects are growing ever more interested in the large business user. Those large users are themselves changing, specifically by consolidating their technology groups. Typically, large users with complex telecommunications systems are beginning to consolidate diverse and formerly discrete responsibilities—voice communications, data communications, systems and planning, and DP/MIS—under an emerging information services officer who usually is a vice president. The reason is simple: Communications today is so fundamental to corporate operations that it is no longer acceptable to have separate and separately managed communications systems. The old barriers are coming down quickly.

Interconnects must take these changes into account when they lay their plans. Large users, for instance, now have centralized planning operations. Even when different corporate locations do their own purchasing, it is increasingly common for the central planning staff to set standards, and review and approve all purchasing decisions. Large users now tend to have primary suppliers, send out formal requests for information and requests for proposal, and do their own system evaluations. In other words, large users now operate much like carriers. Interconnects must offer planning expertise which takes into account the same factors the user's planning group considers.

The key will be to bring complex applications to the user's planning group which fit corporate needs as precisely as possible. The interconnects which penetrate the large user market must sell applications.

Yet many interconnects are failing to position themselves as cost-saving technology planners who can work with users to plan and provide the most practical systems for a given corporate environment, opting instead to continue selling service. Telcos made an analogous mistake in the late '60s and early '70s, creating an opportunity that interconnects hurried to seize.

It may be that the interconnects which do not do application selling choose to believe that conditions in the business market have not changed enough to justify a change in approach. In such a grimly competitive business, management's ability to precisely measure changes in degree and base changes in kind on those measurements is crucial. The market is sure to put that management ability to a rigorous test.

It may also be that some of the top 25 interconnects, excluding the retailers, of course, simply are hesitant to pursue large users. Perhaps they are uncomfortable operating at that level or believe the smaller business customer will provide sufficient demand to keep profits up. Whatever their motivation, look for large interconnects which shun the competition for large users to be involved in additional mergers. □

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